

NICARAGUA

**SOCIAL POLICY REFORM PROGRAM TO SUPPORT THE POVERTY
REDUCTION STRATEGY**

(NI-0169)

LOAN PROPOSAL

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BASIC SOCIOECONOMIC DATA

For basic socioeconomic data, including public debt information, please refer to the following address:

In English:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

In Spanish:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

ABBREVIATIONS

CU	Coordinating Unit
ERCERP	Enhanced Economic Growth and Poverty Reduction Strategy
ERRP	Enhanced Poverty Reduction Strategy
FSO	Fund for Special Operations
FSS	Supplementary Social Fund
GDP	Gross domestic product
GON	Government of Nicaragua
HIPC	Heavily Indebted Poor Countries
IDA	International Development Association
IMF	International Monetary Fund
LGS	General Health Law
LPE	Law on Participation in Education
MECD	Ministry of Education, Culture, and Sports
MHCP	Ministry of Finance and Public Credit
MIFAMILIA	Ministry of the Family
MINSA	Ministry of Health
PAININ	Comprehensive Child Care Program
PRGF	Poverty Reduction and Growth Facility
SECEP	Secretariat for Coordination and Strategy of the Office of the President
SIGFA	Integrated Financial Management, Administration, and Auditing System
SILAIS	Comprehensive local health systems
SNIP	National Public Investment System
WFP	World Food Programme



NICARAGUA

IDB LOANS

APPROVED AS OF SEPTEMBER 30, 2002

	<i>US\$Thousand</i>	<i>Percent</i>
TOTAL APPROVED	1,966,601	
<i>DISBURSED</i>	1,423,825	72.4%
<i>UNDISBURSED BALANCE</i>	542,776	27.6%
<i>CANCELLATIONS</i>	41,293	2.1%
<i>PRINCIPAL COLLECTED</i>	338,692	17.2%
APPROVED BY FUND		
<i>ORDINARY CAPITAL</i>	254,606	12.9%
<i>FUND FOR SPECIAL OPERATIONS</i>	1,645,007	83.6%
<i>OTHER FUNDS</i>	66,989	3.4%
OUTSTANDING DEBT BALANCE	1,085,133	
<i>ORDINARY CAPITAL</i>	127,527	11.8%
<i>FUND FOR SPECIAL OPERATIONS</i>	951,716	87.7%
<i>OTHER FUNDS</i>	5,890	0.5%
APPROVED BY SECTOR		
<i>AGRICULTURE AND FISHERY</i>	361,931	18.4%
<i>INDUSTRY, TOURISM, SCIENCE TECHNOLOGY</i>	78,174	4.0%
<i>ENERGY</i>	202,472	10.3%
<i>TRANSPORTATION AND COMMUNICATIONS</i>	265,641	13.5%
<i>EDUCATION</i>	22,240	1.1%
<i>HEALTH AND SANITATION</i>	175,122	8.9%
<i>ENVIRONMENT</i>	64,240	3.3%
<i>URBAN DEVELOPMENT</i>	57,014	2.9%
<i>SOCIAL INVESTMENT AND MICROENTERPRISE</i>	252,806	12.9%
<i>REFORM PUBLIC SECTOR MODERNIZATION</i>	456,388	23.2%
<i>EXPORT FINANCING</i>	1,826	0.1%
<i>PREINVESTMENT AND OTHER</i>	28,747	1.5%

* *Net of cancellations with monetary adjustments and export financing loan collecti*



NICARAGUA

STATUS OF LOANS IN EXECUTION AS OF SEPTEMBER 30, 2002

(Amounts in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROJECTS	AMOUNT APPROVED	AMOUNT DISBURSED	% DISBURSED
1996 - 1997	4	120,300	103,902	86.37%
1998 - 1999	9	253,175	123,267	48.69%
2000 - 2001	18	312,248	20,525	6.57%
2002	4	107,900	0	0.00%
TOTAL	35	\$793,623	\$247,695	31.21%

* Net of Cancellations . Excluding export financing loans.



Inter-American Development Bank
Regional Operations Support Office
Operational Information Unit

Nicaragua

Tentative Lending Program

2002

Project Number	Project Name	IDB US\$ Millions	Status
NI0160	Modernization Strengthening General Comptrollers	5.4	APPROVED
NI0161	Social Safety Net Stage II	20.0	APPROVED
NI0159	Rural Production Reactivation Program (PRPR)	60.0	APPROVED
NI0064	Low-Income Housing Program	22.5	APPROVED
NI0169	Social Policy Reform	30.0	
NI0165	Commercial Negotiations Capacity Strengthening	5.0	
Total - A : 6 Projects		142.9	
TOTAL 2002 : 6 Projects		142.9	

2003

Project Number	Project Name	IDB US\$ Millions	Status
NI0167	Multisectoral Global Program	30.0	
NI0174	National Program for Competitiveness	7.5	
NI0152	Masaya Basin and Municipality Env Prog	10.0	
NI0172	Sector Reforms Program for Competitiveness	25.0	
NI0170	Road Integration Program PPP	30.0	
Total - A : 5 Projects		102.5	
NI0171	Adult Basic Education and Labor Training	30.0	
NI0168	Citizenship Security Prog.	25.0	
Total - B : 2 Projects		55.0	
TOTAL - 2003 : 7 Projects		157.5	
Total Private Sector 2002 - 2003		0.0	
Total Regular Program 2002 - 2003		300.4	

* Private Sector Project

SOCIAL POLICY REFORM PROGRAM TO SUPPORT THE POVERTY REDUCTION STRATEGY

(NI-0169)

EXECUTIVE SUMMARY

Borrower:	Republic of Nicaragua	
Executing agency:	Ministry of Finance and Public Credit (MHCP)	
Amount and source:	IDB: (FSO)	US\$30 million US\$15 million (first tranche) US\$15 million (second tranche)
Terms and conditions:	Amortization period:	40 years
	Grace period:	10 years
	Disbursement period:	Maximum of 2.5 years and minimum of 1.5 years
	Interest rate:	1% during the grace period and 2% thereafter
	Inspection and supervision:	1%
	Credit fee:	0.50%
	Currency:	U.S. dollars or the equivalent in other convertible currencies, except that of Nicaragua.
Objectives:	<p>The purpose of the proposed program is to help the Government of Nicaragua (GON) implement an Enhanced Economic Growth and Poverty Reduction Strategy (ERCERP) for the social sectors. Fulfillment of the social sector reform conditions, close monitoring of ERCERP priority programs, and achievement of the intermediate targets in the social sectors covered by this program will make it feasible to reach the social sector milestones established in the decision point paper and help the government advance towards the completion point of the Heavily Indebted Poor Countries (HIPC) Initiative. The resulting debt reduction will not only alleviate the fiscal situation and restore the country to a path of economic growth, but will also make it possible to reallocate resources thus released to the social sectors.</p>	

The program has three specific objectives: (i) to facilitate implementation of the ERCERP through the establishment of specific targets and annual monitoring of key performance indicators for the social sectors through 2005; (ii) to prioritize and monitor closely spending on social programs; and (iii) to institute reforms pending in the areas of education, health, and social welfare.

Description:

This operation is a policy-based loan for US\$30 million in unrestricted funds that will be disbursed in two tranches of US\$15 million each.

Disbursement of the first tranche will be contingent on fulfillment of reform conditions, including the establishment of a baseline for selected indicators and intermediate poverty reduction targets for education, health, and social welfare. Disbursement of the second tranche will be based on fulfillment of the reform conditions and the extent to which the targets established for health, education, and social welfare are attained and activities carried out. Fulfilling these conditions which come under the ERCERP will enable the country to reach the HIPC Initiative completion point.

The Bank's country and sector strategy:

The proposed program is consistent with the Bank's strategy for Nicaragua, which includes poverty reduction and sustainable development, and was designed to strengthen social management as a means of coordinating, prioritizing, and monitoring social policy. The Bank has been actively supporting the social sectors in Nicaragua through a Program to Support Implementation of the Enhanced Poverty Reduction Strategy (ERRP), which has already made significant advances in meeting the objectives and targets of the ERRP, which preceded the current ERCERP.

The Bank has also lent support for investment and technical-cooperation programs on social welfare, health, education, basic social infrastructure, child care, and local development.

Environmental and social review:

Social considerations. The objective of the ERCERP is to reduce poverty levels by 50% by 2015. In this context, program actions in the areas of health, education, and social welfare will focus on addressing the unmet needs of the most vulnerable segment of the population.

Environmental considerations. No adverse environmental impact is anticipated, since most of the planned activities will focus on monitoring budget lines and reforms related to standards and regulations in the areas of education, health, and social welfare. National authorities are familiar with Bank environmental standards and regulations, and these will be used should there be adjustments or modifications to reforms in health, education, and social welfare that have an environmental impact (e.g. construction and rehabilitation of

education and health infrastructure, operation and maintenance of hospital and education services, etc.). It should be noted in this regard that there is a condition in the Matrix of Conditions (Annex I) in the plan of action for regulating the General Health Law (LGS) requiring the delivery of medical services to comply with health regulations. Moreover, the Bank is using resources from the Hospital Modernization Support Program (1027/SF-NI) to help consolidate an Environmental Management Unit within the Ministry of Health (MINSa) and standardize environmental management regulations and procedures, particularly for hospitals. This latter operation is financing implementation of waste management plans and rehabilitation of the critical path, in keeping with hydrosanitary and operational flow studies.

Benefits:

The main benefits of the proposed program are to help: (i) reduce poverty in accordance with ERCERP guidelines, principles, and targets, focusing on achieving and fulfilling specific targets; (ii) alleviate the fiscal crisis in the short term, by disbursing unrestricted resources, which also mitigates the risk of increasing poverty as a result of that crisis; and (iii) reduce the country's debt, since the program encourages Nicaragua to reach the HIPC Initiative completion point sooner.

Risks:

One risk is the possible failure to fulfill the reforms required for disbursement of the second tranche. Another risk is related to potential failure to meet the targets set for the intermediate indicators. Lastly, there is the risk of a delay in delivering resources to the line ministries.

An ongoing monitoring system has been established to mitigate these risks. It will make it possible to anticipate timely fulfillment of each of the conditions, thereby ensuring timely disbursement of the second tranche.

Special contractual clauses:

Disbursement of the two tranches of financing will be contingent on fulfillment of the conditions indicated in Annex I to this document, "Matrix of Conditions."

Status of conditions precedent to disbursement of the first tranche:

The Government of Nicaragua has submitted documents related to disbursement of the first tranche of financing, which are being reviewed by the Bank, with the expectation that all the conditions will have been met when this program is presented to the Board.

Poverty-targeting and social sector classification:

Because the program beneficiaries are the people of Nicaragua, including high-risk groups, this operation qualifies as a social equity enhancing project, as described in the indicative targets for Bank activities mandated by the Bank's Eighth Replenishment (document AB-1704). The targets and indicators for monitoring the program will reflect the performance of actions to measure social equity enhancement. Although the proposed program is intended to support poverty reduction in the context of the ERCERP, it does not qualify as a poverty-targeted investment (PTI), because it is a policy-based operation.

Exceptions to Bank policy:

None.

Procurement:

Not applicable, for the reasons given in paragraphs 3.5 and 3.6.

I. FRAME OF REFERENCE

A. Introduction

- 1.1 The purpose of the proposed program is to help the Government of Nicaragua (GON) implement an Enhanced Economic Growth and Poverty Reduction Strategy (ERCERP). Fulfillment of the social sector reform conditions, close monitoring of ERCERP priority programs, and achievement of the intermediate targets in the social sectors covered by this program will make it feasible to reach the social sector milestones established in the decision point paper and help the government progress towards the completion point of the Heavily Indebted Poor Countries (HIPC) Initiative. The resulting reduction in debt payment obligations will not only alleviate the fiscal situation and restore the country to a path of economic growth, but will also make it possible to reallocate resources thus released to the social sectors. In the short term, disbursement of unrestricted resources will alleviate the fiscal crisis, thereby mitigating the risk of increasing poverty, while gearing GON actions towards fulfilling poverty reduction targets in the medium and long term.

B. Macroeconomic situation and outlook¹

- 1.2 In the last three years, the rate of growth of the gross domestic product (GDP) in Nicaragua has steadily slowed (7.4% in 1999, 5.5% in 2000, and 3.0% in 2001). The largest slow-down was in the agricultural sector, due to a severe drought and the collapse of the international price for coffee. The immediate outlook for Nicaragua is difficult. In 2002, despite the beginning of a recovery in the United States, serious macroeconomic imbalances and a still adverse external situation will result in low GDP growth (roughly 1.5%). Nonetheless, a recovery is expected for the Nicaraguan economy at the end of this five-year period, provided the country is able to produce an environment that promotes economic growth and the recovery of the world economy continues. The local recovery would be fueled by exports and private investment in response to policies that promote the country's competitiveness in international markets.
- 1.3 Excessive public spending in 2001 was the main reason the targets set for the second year in the Poverty Reduction and Growth Facility (PRGF) arrangement with the International Monetary Fund (IMF) were not met. Since it failed to fulfill PRGF targets in mid-2001 and in order to present a coherent program for the third year of the PRGF arrangement, Nicaragua negotiated an interim supervision program (SMP) with the Fund, to help the new administration to lay the foundation for a three-year PRGF arrangement starting in 2002. To that end, a new PRGF arrangement is being negotiated and is scheduled to be presented to the Board of the Fund in the fourth quarter of 2002.

¹ Nicaragua. Bank Country Strategy. August 2002.

- 1.4 In relation to the **fiscal situation**, to ensure macroeconomic stabilization, the Bank's analysis notes the importance of reducing the fiscal deficit, which totaled 17% of GDP in 2001 and is preliminarily estimated to be 10% for 2002. Almost half of that deficit (7.4% of GDP) has been financed through grants and the balance through external loans and domestic debt.² However, it is important to mention that GDP is underestimated substantially, which distorts macroeconomic indicators that are calculated as a percentage of GDP. The Bank and other international institutions are working with the government to correct this situation.

C. **The HIPC Initiative and the ERCERP**

- 1.5 The Heavily Indebted Poor Countries (HIPC) Initiative will contribute to macroeconomic sustainability in Nicaragua by reducing its external debt. The total debt reduction could reach US\$3.267 billion in terms of net present value, i.e. 72% of the net present value of the 2001 foreign debt. Nicaragua reached the HIPC Initiative decision point in December 2000, making it eligible for interim debt service relief, which could represent up to one-third of total relief. The main conditions for permanently reducing debt under the HIPC Initiative (completion point) are to have a PRGF agreement with the Fund and to execute the ERCERP over a period of one year, in addition to achieving key reforms, particularly in the social sector.
- 1.6 Following extensive consultation with civil society and international financial institutions, Nicaragua adopted the ERCERP in July 2001, reflecting the government's commitment to expanding and improving the allocation of resources targeting poverty. This commitment transcended a political cycle when the new administration took office in January 2002. The ERCERP not only establishes guidelines for poverty reduction, but also sets the goal of reducing extreme poverty by 50% between 1995 and 2015. To fulfill that goal, the country must have a substantial, sustainable rate of growth. The supply of essential services must also be expanded to enhance the productivity of low-income groups. Therefore, other significant targets to be reached by 2015 include reducing infant mortality from 40 to 32 per 1,000 live births, lowering the illiteracy rate to 17%, and increasing access to water supply in rural areas from 39% to 54% of households.
- 1.7 Although the ERCERP is considered to be sound and coherent, the following challenges for its implementation have been identified. There is a need to: (i) make progress on institutional reforms in the social sector; and (ii) develop tracking mechanisms within the financial management system for expenditures in ERCERP programs.³

² "El Seguimiento del Gasto Público en Nicaragua" [Monitoring Public Expenditure in Nicaragua]. Carlos Oliva. See program files.

³ IDA and IMF. Poverty Reduction Strategy Paper. Joint Staff Assessment. August 27, 2001.

D. Poverty reduction spending and its outlook

- 1.8 Even though a drop has been forecast in total government spending as a percentage of GDP from 42.1% to 33.2% in the period 2001-2005, poverty reduction spending by the central government is projected to rise from 13.6% to 16% of GDP in that period.⁴ In this regard, all the programs are designed to support the pillars of the ERCERP, including those of the Ministries of Education, Culture, and Sports (MECD), Health (MINSA), and the Family (MIFAMILIA), which are participating in the program.
- 1.9 In the event that GDP growth is below expectations⁵ or there is a greater-than-anticipated drop in government spending, maintaining the projected percentages could constitute a real drop in poverty spending, at least compared to initial projections. This possibility makes it necessary to protect at least certain categories in education, health, and social welfare (see paragraph 2.8) and, in particular, to increase the efficiency and enhance the quality of such spending, which is one of the main objectives of the proposed program.
- 1.10 As an example of this point, in the context of low social spending, the health sector illustrates the need for close monitoring of strategic spending categories. That sector maintains annual per capita expenditure of US\$27 which is below the US\$33 per annum set by the World Health Organization as the minimum for guaranteeing access to basic services. Per capita spending by MINSA is declining, falling to US\$14.4 in 2001. In addition, MINSA's share of the total government budget has shrunk to 12%. Regarding capital expenditures, the rise in hospitals' share in the universe of perinatal and maternal mortality is due in part to the limited share of public investment that this sector has received. A review of these figures in 2002 indicates that hospitals received only 12% of MINSA's capital budget allocations, and budget cuts (in the last two fiscal years) have tended to affect this category in particular. Other categories that warrant special attention are drugs and pharmaceuticals, hospital rehabilitation, hospital equipment maintenance, and provision of surgical instruments. In education, MECD recurrent spending per student was US\$46 in 2001; resources must be allocated, particularly, to support school autonomy, textbooks, training materials, and teacher incentives. Since MIFAMILIA is in the process of identifying the different social welfare programs being executed by various institutions, for the purposes of this program "social welfare" will refer strictly to MIFAMILIA programs. Special attention must therefore be paid to the MIFAMILIA social safety net program to provide vulnerable communities with food and health coupons, *inter alia*.

⁴ According to Secretariat for Coordination and Strategy of the Office of the President (SECEP). This organization made an effort to identify each expenditure category, in accordance with the four underlying principles of the ERCERP, to obtain the figures given.

⁵ A difference is already anticipated in 2002; GDP growth is forecast at 1.5% instead of the 3.7% estimated in the ERCERP.

E. Pending reforms in the social sectors

- 1.11 Regarding the quality of social spending, the HIPC Initiative establishes clear guidelines for reaching the completion point, identifying a limited number of key reforms in education, health, and social welfare, to enhance the efficiency and equity of those sectors. These government commitments to civil society and the donor community make it possible to target reform efforts in each area of the social sector; therefore, it was decided to use them as a frame of reference for the policy conditions in the proposed program.
- 1.12 In the **education** sector, in 1993 the Ministry of Education, Culture, and Sports (MECD) launched a school autonomy process based on: (i) a transfer of fiscal resources to schools; (ii) parental control over resources at the school level; and (iii) the authority of the school board to hire and dismiss school personnel, including principals. School autonomy has proven to have a positive impact on the quality of instruction. To date, MECD administrative decisions have formed the legal foundation for school autonomy; therefore, to reach the HIPC Initiative completion point, a substantive law on school autonomy must be approved. The National Assembly adopted the Law on Participation in Education (LPE) in March 2002, and its general and specific regulations will stipulate substantive fulfillment of these conditions. The key elements to be regulated include: (i) the administration and management of regular and special transfers of resources to schools; (ii) school board functions and powers, including the process of electing, replacing, and re-electing their members and how school boards are to be trained, evaluated, and supervised; and (iii) procedures for adding new schools to the participation-in-education system.
- 1.13 The formula for fiscal transfers to autonomous schools is based on the number of students enrolled, which facilitates calculation of the allotment and its adjustment in keeping with increases and decreases in enrollment. However, administrative implementation of the formula has created inequities and inefficiencies since, once the number of students is determined, the MECD ranks schools according to eight enrollment levels to determine the number of teachers and administrative staff it will finance. This practice has caused problems, because schools at the bottom of each level receive up to 60% more resources than those at the top, and the pupil/teacher ratio varies up to 66%. Application of the formula has also limited the scope of autonomy in terms of participation, because both the number and the make-up of staff are determined centrally by the MECD.
- 1.14 As regards **health**, the HIPC Initiative requires the adoption of a new General Health Law (LGS) and the corresponding regulations to strengthen the normative and regulatory role of the Ministry of Health (MINSA) and establish a sound legal framework for modernizing the sector, granting increased autonomy to hospitals and local health systems. Following several years of consultation and dialogue, the National Assembly adopted a new LGS in early 2002. Its regulations, which are

scheduled to be developed in 2002 and the first half of 2003, will require sustained work under the leadership of MINSAs, but with the participation of various disciplines and institutions. The core elements to be regulated include: (i) the operation, financing, and benefit plans of current contribution, non contribution, and voluntary systems; (ii) the organization and operation of the governing and consultative bodies of service delivery institutions, emphasizing hospital advisory boards, including users' rights; (iii) models to promote decentralization, deconcentration, and delegation within the health sector, stressing mechanisms to promote the transfer of competencies and resources; (iv) the quality assurance system, including authorization and accreditation of providers; (v) programs to care for high-cost illnesses; and (vi) the requirement that delivery of medical services comply with health regulations.

- 1.15 Although it is included in the broad sphere of regulation of the LGS, the issue of decentralization has a specific connotation and strong implications for the feasibility of ERCERP targets. The regulatory framework that supports decentralization efforts included, firstly, the creation of comprehensive local health systems (SILAIS) in 1990. Hospitals, under the aegis of the SILAIS, do not have the legal capacity to prepare and execute budgets, since decisions are made centrally. This level of care accounts for one-third of the general budget, but bed occupancy (69% on average) and discharge (6.6 per 100 inhabitants) figures are low. The weakness of hospitals hinders health care outcomes at the primary care level; in the case of maternal and child care and its related health indicators, over 65% of maternal and perinatal mortality is due to shortcomings in hospital care. Meanwhile, the low occupancy and scant productivity of hospitals have been related to the lack of competence to make financial decisions and independently use cost-recovery resources. It is therefore important to back efforts to enhance the quality of spending for secondary level care, promoting decentralized hospital management. To that end, MINSAs has gradually been preparing hospitals to assume new administrative and financial responsibilities, by implementing programs to improve management and install computer support for resource management.
- 1.16 Delivery of nonhospital primary care services also presents significant shortcomings, including the coexistence of various models that are not always adequately aligned. This issue is a combination of regulatory problems and expenditure inefficiency. Since 1994, there have been efforts to design and apply a new, unified health care model. However, there is fragmentation in the models implemented (at present there are eight different primary care models financed by seven projects that either duplicate efforts or overlap one another), and they still do not meet the demand for care (although real expenditures rose by 50% from 1993 to 1998 and the number of primary care units rose 20%, production of services at the primary level increased by only 13%). Moreover, due to the complexity of these

programs, available information does not allow for a cost-efficiency comparison of the models to set a sector standard.⁶

- 1.17 Finally, in the area of **social welfare**, to reach the HIPC Initiative completion point, there is a commitment to adopt an action plan for introducing an effective program based on experience from a pilot social safety net program launched in 2000 and financed in part by the Bank. In the future, the two key factors indicated for continuing to reduce poverty are: broad-based economic growth and a social safety net.⁷ In a recent policy letter sent to the Bank, Nicaraguan authorities said that, “the actions in this sector have been marked by institutional weakness and lack of coverage, duplication of efforts, a social welfare concept based on rights, and limited measurement of results.” Currently, implementation of the ERCERP means that the government, in policy actions, is fulfilling institutional and legal strengthening commitments, such as framing effective social policy, defining a targeted social welfare system based on a network of social safety net programs, organizing the program and project portfolio, and designing an effective plan for coordination and broad-based participation by key actors in the different ministries, both at the central and local levels, including the poorest groups. These guidelines identify, in a concrete, targeted manner, the intermediate steps needed to implement the third pillar of the ERCERP—social welfare.

F. Bank experience in the country and social sector

- 1.18 The proposed program is consistent with the Bank’s strategy for Nicaragua, which accords particular importance to poverty reduction and sustainable development and was designed to strengthen social management as a means of coordinating, prioritizing, and monitoring social policy. The Bank has been actively supporting the social sectors in Nicaragua through a Program to Support Implementation of the Enhanced Poverty Reduction Strategy (ERRP), which has already made significant progress in meeting the objectives and targets of the ERRP, which preceded the current ERCERP, particularly in the selection of participating municipios and in working with mayor’s offices, institutions, and civil society at the decentralized level, awarding financing for local investment plans. Another important project directly related to the ERCERP is the Social Safety Net (Phases I and II); the evaluation of Phase I of that project has shown the targeting and incentives for school retention and health services coverage compliance to be effective. The Bank has also lent support for investment programs and technical-cooperation operations on health, education, basic social infrastructure, child care, and local development (see program files).

⁶ Available data do not make it possible to evaluate costs per beneficiary of specific primary care services or their impact.

⁷ Nicaragua. Poverty Assessment Follow-up. May 2, 2002.

- 1.19 Thanks in particular to the projects financed by the Bank, important progress and advances have been made in the social sectors, however some weaknesses have also been detected in execution capacity, both at the individual level and in those operations that require interagency coordination. The policy conditions agreed to in the three areas, particularly social welfare, seek to mitigate those weaknesses by supporting the organizational structure promoted by the new administration, in accordance with the fourth pillar of the ERCERP, which is directly related to governance. More importantly, due to Nicaragua's commitment to fulfill the ERCERP, the proposed program will unite country and Bank efforts to support a plan in which budget lines and categories will be closely monitored to ensure appropriate allocation of resources for programs benefiting the most marginalized, vulnerable sectors of the population.
- 1.20 Finally, there has been ongoing inter-institutional coordination and communication with the IMF and the International Bank for Reconstruction and Development (IBRD), to have consistent, complementary actions and prevent duplication of efforts by the three institutions.

G. Program rationale

- 1.21 Even though Nicaragua made significant progress in poverty reduction in the 1990s, particularly with support from the Bank and the international community, high levels of poverty and deprivation persist, including a deterioration in the maternal mortality rate and slow progress in the net primary school enrollment rate. It is hoped that this strengthening will achieve greater development of human capital—an essential prerequisite for poverty reduction. To do so, the following are needed: (i) establishment of concrete targets for social indicators on poverty reduction and of monitoring systems; (ii) prioritization and close monitoring of programs to achieve ERCERP poverty reduction targets; implementation of that strategy for one year is a condition for reaching the HIPC Initiative completion point; (iii) reforms in the management and organization of the social ministries; and (iv) institutional reforms at government programming levels. These reforms, together with the establishment of priorities and targets, are the key elements of this program.
- 1.22 The proposed program also supports the Government of Nicaragua (GON) in its efforts to strengthen the future domestic fiscal situation by increasing the probability of it beginning to receive all the debt relief under the HIPC Initiative as scheduled. Indeed, the program expects to focus the attention of the GON on key social actions and to help achieve better conditions for reaching the HIPC Initiative completion point. Disbursements under the proposed program would support the government in its effort to build up international reserves and reduce the country's current financial vulnerability.

II. THE PROGRAM

A. Objectives

- 2.1 The objective is to move forward in achieving the poverty reduction targets in Nicaragua set in the ERCERP for the social sectors. Such progress is necessary to reach the HIPC Initiative completion point. The program has three specific objectives: (i) to facilitate implementation of the ERCERP through the establishment of specific targets and annual monitoring of key performance indicators for the social sectors through 2005; (ii) to prioritize and monitor closely spending on social programs; and (iii) to institute reforms pending in the areas of education, health, and social welfare.

B. Description

- 2.2 This operation is a policy-based loan for US\$30 million that will be disbursed in two tranches of US\$15 million each. Disbursement of the first tranche will be contingent on fulfillment of reform conditions, including the presentation of a baseline of selected monitoring indicators for education, health, and social welfare. Disbursement of the second tranche will be based on fulfillment of the reform conditions and the extent to which the targets established in the first tranche for health, education, and social welfare are attained and actions in those areas are carried out. Fulfilling these conditions coming under the ERCERP will enable the country to reach the HIPC Initiative completion point. Annex I contains the Matrix of Conditions.
- 2.3 It is important to note that both the analysis of problems and the definition of and agreements on policy actions and changes included in Annex I were developed and agreed to together with the entities responsible for their fulfillment. Regardless, the feasibility of compliance with each condition within the scheduled time frame and the ready availability of the resources to support execution have been confirmed.

1. ERCERP intermediate performance indicators

- 2.4 As a general macroeconomic conditionality during program execution and in order to make the respective disbursements, the Government of Nicaragua must maintain a macroeconomic environment consistent with program targets. Fulfillment of the education, health, and social welfare targets will also be verified. Annex II presents the selected intermediate indicators by sector, the baseline for 2001, and annual targets through 2005. The program files contain a Technical Annex that includes the methodology for determining those indicators.
- 2.5 Intermediate indicators will be selected for education, health, and social welfare and will be considered as input or markers of progress in achieving ERCERP targets.

To fulfill the targets for those indicators, spending and attention must be redirected in both sectors. The intermediate indicators for ERCERP targets will be verified. For example, the ERCERP includes a target for increasing access to primary education; one of the intermediate targets that will be tracked will be initial preschool and primary school enrollment in rural municipios and areas marked by severe and high poverty. The setting of the indicators and targets to be met is part of the agreement with the GON in the areas of education, health, and social welfare and is a condition for disbursement of the first tranche. Compliance with targets is controlled by MINSA and the MECD respectively; they will also be responsible for producing verification data annually for fulfillment of the intermediate targets.

- 2.6 The GON has presented to the Bank's satisfaction: (i) the baseline (2001) for the intermediate indicators, including the calculation methodology and the agencies responsible for gathering the information; and (ii) the definition of the annual targets through 2005 (Annex II). The targets were established through 2005 to establish monitoring of the social sector over and above the disbursements in this operation and the HIPC Initiative completion point. Given that the Supplementary Social Fund (FSS) is a sound coordination and information mechanism for information-related activities to monitor the ERCERP (paragraph 3.9), evidence must be presented that its operating regulations have been enacted and are in effect. For the **second tranche**, a report must be presented on the intermediate indicators for monitoring the ERCERP, demonstrating that the targets (for 2002 and 2003) have substantially been fulfilled. Likewise, evidence will be presented that the status of fulfillment of the annual ERCERP targets has been disseminated through different media nationwide.

2. Prioritizing and monitoring social programs

- 2.7 The Bank and the Government of Nicaragua have agreed on priority budget lines related to poverty reduction spending. Given the nature of the education, health, and social welfare activities identified, all the priority budget lines for 2002 and 2003 are consistent with eight of the ten programs prioritized in the ERCERP. The financial and budget targets that will be monitored in this program are broken down in the Table II.1. A breakdown of the budget lines and quarterly physical and financial targets for 2003 is presented in Annex III.

Table II.1
Nicaragua: Priority budget lines
(in US\$ millions)

Category	2002	2003
Education	43.3	46.0
Health	11.8	12.7
Social welfare	2.3	1.5
Total	57.4	60.2
% of the program in the MECD budget	40%	44%
% of the program in the MINSA budget	10%	12%
% of the program in the MIFAMILIA budget	22%	9%

Source: GON

- 2.8 The budget lines in **education** include programs that foster equity and quality in primary education for the poorest populations (including municipios with high and extreme poverty) and require sustained investment. These lines finance inputs and actions directly related to education quality, such as textbooks, materials and training, and teacher incentives. The budget allocation for these social program expenditures will be verified, and their execution will be monitored by establishing physical and financial targets. For **health**, the priority line is primary care nationwide, particularly at the rural level, including: (i) drugs and pharmaceuticals; (ii) hospital equipment maintenance; (iii) rehabilitation of national and rural hospitals (including, in an initial phase, Puerto Cabezas, Bluefields, and San Carlos hospitals); and (iv) provision of surgical instruments for health units. Finally, for **social welfare**, the priority budget lines include activities related to the social safety net of MIFAMILIA, the MECD, and MINSA to provide vulnerable communities with food coupons, school packs, and education incentive and health coupons.
- 2.9 In mid-2003, the Bank and the Government of Nicaragua will jointly conduct a similar exercise to review the 2003 physical and financial targets and 2004 budget projections; that information will be used in processing the disbursement of the second tranche, initially scheduled for mid-2004. Particular attention will be paid to the resources allocated for 2004, which must not be less than those budgeted for 2003 to ensure that budget targets are met.

3. Reforms for development of human capital and social welfare

- 2.10 In **education**, for disbursement of the first tranche, the program Matrix of Conditions (see Annex I) requires that the Law on Participation in Education (LPE) be promulgated and in force, in accordance with the text approved by the National Assembly in March 2002. There must also be proof that resources have been included in the 2003 General Budget of the Republic for school autonomy programs, education incentives, and adult education. In addition, the Ministry of Education, Culture, and Sports (MECD) must present evidence to the Bank's

- satisfaction that ministerial agreements on the following issues have been issued and are in force: (i) the operation of the electoral and ethics supervisory body; (ii) the functions and powers of the assembly of parents; (iii) the functions and powers of the councils of teachers; (iv) the organization and operation of student governments; and (v) the functions and powers of school boards, including the process of electing, replacing, and re-electing their members and how school boards will be trained, evaluated, and supervised. It will also be shown that the formula for administering and managing regular and special transfers of resources from the General Budget of the Republic has been modified, to guarantee equitable treatment of schools by level and size.
- 2.11 The new formula must be amended in order to promote: (i) equitable treatment of schools and provide for incentives, in keeping with compensation criteria based on the socio-economic disadvantages of the population; and (ii) the elimination of incentives that produce opportunistic behavior in the use and transmission of information.
- 2.12 For disbursement of the second tranche, the General Budget of the Republic will be monitored closely to verify budget allocation of the prioritized lines and intermediate indicators and targets set forth in Annex II and that other actions that are the responsibility of the MECD have been approved and put into effect, such as: (i) a manual of procedures for the financial administration of schools in the participation-in-education system that includes regulation of the administration and management of regular and special transfers of resources to schools; and (ii) a manual of procedures for adding new schools to the participation-in-education system. In addition, the ministerial agreements on the LPE referenced in paragraph 2.10 must have been disseminated to at least 25% of the schools; and resources must have been transferred to schools by applying the adjusted resource transfer formula mentioned in paragraph 2.11.
- 2.13 Regarding the **health sector**, for disbursement of the first tranche, the Matrix of Conditions (See Annex I) will require that the General Health Law be adopted and in force, in accordance with the text approved by the National Assembly in May 2002. The 2001 baseline on spending in the health sector must also be presented, including: (i) the percentage of total government expenditure allocated to the MINSA; and (ii) the amount of recurrent per capita spending on primary health care in at least ten comprehensive local health systems (SILAIS). Proof must also be presented that the 2003 General Budget of the Republic incorporates resources for: (i) drugs and pharmaceuticals; (ii) hospital equipment maintenance; (iii) strengthening rural primary health care; (iv) rehabilitation of national and municipal hospitals (including the Puerto Cabezas, Bluefields, and San Carlos hospitals); and (v) provision of surgical instruments to health units. The plan of action for regulation of the LGS in the areas mentioned in the next paragraph, the proposal on the new, unified primary health care model, and the framework

agreement between the MHCP and MINSA for the transfer of resources to hospitals will also be presented to the Bank's satisfaction.

- 2.14 Through the LGS, priority will be given to regulating the following areas: (i) the operation, financing, and benefit plans of current contribution, no contribution, and voluntary schemes; (ii) the organization and functioning of the governing and consultative bodies of service delivery institutions, stressing hospital advisory boards, including users' rights; (iii) the models to promote decentralization, deconcentration, and delegation within the health sector, with special emphasis on mechanisms to promote the transfer of competencies and resources; (iv) the quality assurance system, including the authorization and accreditation of providers; and (v) care programs for high-cost illnesses, including the requirement that delivery of medical services comply with health regulations.
- 2.15 In the case of hospitals, issuance of a framework agreement between MINSA and the MHCP to regulate the direct transfer of budget resources to hospitals will be promoted. The agreement will be binding for formulation of the 2004 budget. In 2004, at least four hospitals are expected to receive and directly manage the resources.
- 2.16 Progress must also have been made in defining a unified primary health care model, including: (i) the definition of the methodology for evaluating current models; (ii) the definition of the terms of reference for the consulting firm that would develop the new model; and (iii) the selection of said firm. Implementation of that model is expected to generate savings in the 2003 and 2004 budgets; MINSA will use those savings for priority projects targeting the primary level of care, stressing mothers and children in populations with high poverty.
- 2.17 For the disbursement of the second tranche, the General Budget of the Republic will be monitored closely to verify budget allocations to the priority lines and indicators and intermediate targets broken down in Annex II, as well as other measures related to implementation of the following actions agreed to for the first tranche. The new, unified primary health care model must have been approved and adopted as the mandatory standard for implementation, regardless of the source of financing, and the adjustments for applying this model to projects currently under way must be in the process of being negotiated with the financing institution. Performance of cost-efficiency evaluations and adoption of the unified primary health care model that should serve as the national standard for the sector would enhance the overall efficacy of programs, reduce the fixed costs of administering a variety of primary care models, and generally increase efficiency and enhance equity in the sector. Evidence must also be presented that the regulations of the LGS in the areas mentioned in paragraph 2.14 are in force. Likewise, the SECEP must present proof that: (i) the percentage of public spending allocated to MINSA; and (ii) the amount of recurrent per capita spending on primary health care in the 10 SILAIS identified for disbursement of the first tranche, are no less than the

baseline levels for that tranche. It will also be verified that at least four hospitals: (i) have advisory boards operating; and (ii) have received transfers of budget resources from the MHCP, in application of the framework agreement presented for the first tranche.

- 2.18 Regarding **social welfare**, for disbursement of the first tranche, the Matrix of Conditions (Annex I) indicates that evidence must be presented that the 2003 General Budget of the Republic includes resources for programs serving the most vulnerable groups in the country as regards: (i) comprehensive care for high-risk children and adolescents; (ii) MIFAMILIA, MECD, and MINSA social safety nets; (iii) repairing transportation facilities; and (iv) charitable institutions. The following must also be presented to the Bank's satisfaction: (i) a ministerial agreement approving the formulation of a common methodological basis for targeting MIFAMILIA social welfare programs, based on the lessons learned in the Social Safety Net Program, Phase I, and the Comprehensive Child Care Program (PAININ), Phase I; (ii) an action plan for reorganizing low-coverage MIFAMILIA social welfare programs; (iii) the methodology for evaluating the PAININ and terms of reference for evaluating the World Food Programme (WFP) program for Nicaragua, including identification of the control group and hypotheses in indicators to be included and independent data collection and analysis; and (iv) evidence that a plan has been presented for the administrative reorganization of the WFP program for Nicaragua. For disbursement of the second tranche, the General Budget of the Republic will be monitored closely to verify budget allocations for the prioritized lines, the intermediate indicators and targets in Annex II, and other measures related to implementation of the following actions agreed to for the first tranche: (i) that MIFAMILIA social welfare programs are using the common methodological basis for targeting that was agreed to with the Bank for disbursement of the first tranche; (ii) that MIFAMILIA social welfare programs have been reorganized and/or consolidated, in accordance with the plan of action presented for disbursement of the first tranche and that this reorganization is reflected in the budget lines of the General Budget of the Republic; (iii) that a consolidated administrative unit has been formed for WFP programs in Nicaragua; and (iv) that the baseline evaluation data collected by independent firms are available for the PAININ and WFP programs.

C. Cost and financing

- 2.19 The total cost is estimated at US\$30 million in resources from the Fund for Special Operations (FSO) in U.S. dollars or the equivalent in other convertible currencies, except that of Nicaragua. The financing was divided into two tranches of US\$15 million each, to be disbursed once fulfillment of the conditions in the Matrix of Conditions (Annex I) has been verified.

2.20 The terms of the loan are outlined below:

Source of financing:	Fund for Special Operations (FSO)
Operation amount:	US\$30 million
Amortization period:	40 years
Grace period:	10 years
Disbursement period:	Maximum of 2.5 years and minimum of 1.5 years
Interest rate:	1% during the grace period and 2% thereafter
Inspection and supervision:	1% of the total loan amount
Credit fee:	0.50% per annum on the undisbursed balance, starting twelve months after the date the operation is approved by the Board.
Currency:	U.S. dollars or the equivalent in other convertible currencies, except that of Nicaragua.

III. PROGRAM EXECUTION

A. Borrower and executing agency

- 3.1 The borrower will be the Republic of Nicaragua, and the executing agency will be the Ministry of Finance and Public Credit (MHCP).

B. Overall administration and execution of the program

- 3.2 Coordination and execution responsibilities for this operation will be assumed by the MHCP, with support from the Secretariat for Coordination and Strategy of the Office of the President (SECEP) through the Coordinating Unit (CU) composed of a director general, a technical director, and an administrative specialist from the MHCP and the SECEP. Those experts have experience managing and administering programs with international financing.
- 3.3 The MHCP will be responsible for allocating resources for the priority budget lines in the program (see paragraph 2.8), and the CU will be responsible for program administration, supervision, and monitoring, coordinating its activities with the MECD on issues related to education, with MINSA on health, and with MIFAMILIA on social welfare.
- 3.4 The CU's responsibilities include: (i) coordinating the fulfillment of the Matrix of Conditions (Annex I) and the Global Targets and Intermediate Performance Indicators (Annex II) with the MECD, MINSA, and MIFAMILIA, to access the disbursements in the two program tranches; (ii) acting as the MHCP's technical partner; and (iii) coordinating preparation of the required reports and their presentation to the Bank.

C. Execution period, amounts, schedule, and disbursement conditions

- 3.5 The execution period will be 24 months, and the unrestricted resources will be disbursed in two tranches of US\$15 million each. Disbursement of the first tranche is scheduled for the fourth quarter of 2002, and disbursement of the second tranche is estimated to take place 18 to 24 months after the loan contract takes effect.
- 3.6 The Matrix of Conditions (Annex I) breaks down the requirements for accessing resources in the two tranches proposed in the program; they are related to: (i) the economic environment; (ii) ERCERP-related social indicators; (iii) prioritization and tracking of social spending on education, health, and social welfare; and (iv) management by the MECD, MINSA, and MIFAMILIA associated with execution of the ERCERP.

D. Program monitoring and evaluation

- 3.7 A decision was reached with the Government of Nicaragua to establish a quarterly plan for monitoring the policy actions set forth in Annex I. There will also be ongoing monitoring of the global targets and intermediate indicators listed in Annex II related to the ERCERP in the areas of health, education, and social welfare. In addition, in order to evaluate the extent of compliance with program objectives, the changes recorded in the period 2001-2005 in nine proximate impact indicators for ERCERP targets will be analyzed (Annex IV), together with other results that emerge in the medium term from implementation of the intermediate indicators and policies (Annex II). To that end, the GON will present to the Bank, in the first quarter of each calendar year for the duration of the program, preliminary annual reports on the progress made in implementing the program and, within the next two months, will present the final report, based on the preliminary reports. The impact indicators will be monitored through two annual reports. To that end, the borrower will present preliminary impact reports to the Bank; the first will be submitted in 2004 and the second in the year agreed to by the GON and the Bank. In addition, one ex-post final impact evaluation report will be presented within two years of disbursement of the second tranche.
- 3.8 As part of preparation of the ERCERP, the Government of Nicaragua established and further developed different monitoring, control, and evaluation mechanisms, which have been independently evaluated and are considered appropriate for these purposes.⁸ They will be used to monitor this program.
- 3.9 The **Supplementary Social Fund (FSS)** was created in 1998 to channel additional concessional resources to the education, health, and social welfare sectors from grants or external sources, as a bridge until Nicaragua can accede to the HIPC Initiative. The FSS, as a virtual coordination mechanism presided over by the SECEP and in which the line ministries and the MHCP approve the allocation of resources, has been important in organizing the use of resources, particularly when there are multiple donors and for intersectoral programs. The new operating regulations for the FSS have already been approved and emphasize its function as coordinator, not executor, of all the resources involved in the ERCERP, i.e., funds from abroad (grants, loans), generated domestically, or resulting from relief under the HIPC Initiative. For disbursement of the first tranche, the new operating regulations must be approved by decree and published in the Official Bulletin and presented to the Bank's satisfaction.
- 3.10 The coordinating role of the FSS means it is involved in a series of processes with the central bank, which calculates the HIPC resources, as well as the MHCP, which is responsible for preparation, control, and monitoring of the budget, and the

⁸ “*El Seguimiento del Gasto Público en Nicaragua*” [Monitoring Public Expenditure in Nicaragua]. Carlos Oliva. See program files.

SECEP, which is responsible for allocating capital expenditures and monitoring performance indicators. Thus, the FSS is a vital support tool for the MHCP, to enable it to monitor the budget. To that end, the FSS will rely on the two complementary mechanisms described below: the Integrated Financial Management, Administration, and Auditing System (SIGFA) and the National Public Investment System (SNIP).

- 3.11 The **Integrated Financial Management, Administration, and Auditing System (SIGFA)** was created in 1998 to coordinate standards and procedures for budget, accounting, cash flow, public credit, and information system operations that, by interrelating operational data, provides effective support for decision-making and internal and external government control processes. Its sphere of application is recording budget execution of revenue and expenditures; entering financial and equity operations into the accounts; regular preparation and presentation of financial, budget, and equity statements; reconciling bank accounts; and monitoring, analysis, and evaluation of financial and equity execution.
 - 3.12 For the purposes of this program, the SIGFA has the capacity to generate precise, truthful information on budget execution by the central government that can be broken down to the level of activities or works in each project, by sector, with the economic classification (current or capital expenditure) and source of financing. Therefore, any strictly financial indicator of the central government can be calculated with the periodicity desired.
 - 3.13 The **National Public Investment System (SNIP)** is another important tool for tracking public expenditure that seeks to streamline the identification, formulation, evaluation, selection, programming, execution, and monitoring of projects that make up the annual and multi-year public investment program. The SNIP records all public investment-related transactions, from programming to execution and monitoring.
 - 3.14 The SNIP has a computerized system for processing project information, which has records by program. SNIP data include the sector, economic use, project description, functional classification of the expenditure, source of financing, amounts, and impact indicators by municipio. At present, each program component is also related to the pillars of the ERCERP. For the purposes of this program, the SNIP is an important tool for monitoring investment loans from the Bank and, in general, those related to the ERCERP. Having physical indicators (work status, for example) and impact indicators provides an additional advantage for preparing more complex, useful indicators.
- E. Policy letter**
- 3.15 The policy letter sent by the Government of Nicaragua (Annex V) presents a summary of economic policies and the commitment to implementing the ERCERP

and to making significant advances in health, education, and social welfare policies, measured by specific indicators.

F. Inspection and supervision

- 3.16 The Bank will establish the inspection procedures it deems necessary for satisfactory execution of this policy reform program. The borrower will fully cooperate by providing all assistance and information needed for that purpose. The project team, in close coordination with the Bank's Country Office in Nicaragua (COF/CNI), will be responsible for supervising program execution. Supervision will be ongoing in that, in addition to the progress reports mentioned in paragraph 3.7, the program will have an accessible monitoring system for reviewing progress between inspection visits, portfolio reviews, or administration missions. At the request of the Country Office, the administration and technical supervision missions needed for optimal project execution will be performed in principle, and at a minimum, on a yearly basis.
- 3.17 For this purpose, the following will be examined during Bank visits: (i) progress made in overall program execution; (ii) execution of each component; (iii) budget allocations for each component; (iv) the efficacy and efficiency of program activities; (v) experiences and difficulties encountered in executing those activities; (vi) fulfillment of the targets set for each component; and (vii) other relevant issues in relation to program execution, to verify the extent to which the program objective is being met.

IV. FEASIBILITY AND RISKS

A. Political, technical, and institutional feasibility

- 4.1 The ERCERP has the support of Nicaraguan society, all the political parties, and the international cooperation community. There was broad civic participation in devising the strategy, which gives it legitimacy and a solid foundation for future execution. The Government of Nicaragua has committed to implementing the ERCERP, which should reduce extreme poverty in the country by at least 50% by 2015. Significant progress has been made in implementing the strategy in the context of its four essential pillars; pillars two and three—more and better investment in human capital and better protection of vulnerable groups—are targeted by this program.
- 4.2 The monitoring, control, and supervision instruments are in line with Bank requirements. The MHCP, with support from the SECEP, will be responsible for coordinating and promoting activities to comply with the conditions outlined in the Matrix of Conditions (Annex I). The SECEP Coordinating Unit is composed of specialists and experts who were also involved in designing the proposed program. This will ensure that there is an appropriate counterpart to monitor program execution and timely fulfillment of the intermediate indicators and targets agreed to with the Bank (Annex II). Moreover, the Government of Nicaragua has established and further developed different internal monitoring, control, and evaluation mechanisms (FSS, SIGFA, and SNIP); they have been independently evaluated and are considered appropriate for these purposes.
- 4.3 Regarding the technical feasibility of the activities required to fulfill the conditions, each of them was defined and agreed to in close coordination with the line ministries responsible for their fulfillment, together with SECEP experts. The policy letter reflects the consensus on the feasibility of the actions, the feasibility of their being implemented within the scheduled time frame, and the government's commitment to them (see Annex V).

B. Benefits

- 4.4 The main benefits of the proposed program are to help: (i) eradicate poverty in accordance with ERCERP guidelines, principles, and targets, focusing on achieving and fulfilling specific targets; (ii) alleviate the fiscal crisis in the short term, by disbursing unrestricted resources, which also mitigates the risk of increased poverty as a result of that crisis; and (iii) reduce the country's debt, since the program encourages Nicaragua to reach the HIPC Initiative completion point sooner.

C. Environmental considerations

- 4.5 The proposed program is feasible from an environmental standpoint. That is because no adverse environmental impact is anticipated, since most of the planned activities will focus on monitoring budget lines and reforms related to standards and regulations in the areas of education, health, and social welfare. National authorities are familiar with Bank environmental standards and regulations, and these will be used should there be adjustments of changes to reforms in health, education, and social welfare that have an environmental impact (i.e., construction and rehabilitation of education and health infrastructure, operation and maintenance of hospital and education services, etc.). It should be noted in this regard that there is a condition in the Matrix of Conditions (Annex I) in the plan of action for regulating the LGS requiring the delivery of medical services to comply with health regulations. Moreover, the Bank is using resources in the Hospital Modernization Program Support (1027/SF-NI) to help consolidate an Environmental Management Unit within MINSA and standardize environmental management regulations and procedures, particularly for hospitals. This latter operation is financing implementation of waste management plans and rehabilitation of the critical path, in keeping with hydrosanitary and operational flow studies.

D. Risks

- 4.6 One risk of the proposed program is the possible failure to carry out the reforms required for disbursement of the second tranche. Another risk is related to potential failure to meet the targets set for the intermediate indicators (component 3). Lastly, there is the risk of delay in delivering resources to the line ministries, which would have a negative impact on the indicators. To mitigate these risks, an ongoing monitoring system was established that even uses existing mechanisms (FSS, SIGFA, and SNIP); this will make it possible to anticipate timely fulfillment of each and every condition, thereby ensuring timely disbursement of the second tranche.

E. Program impact on women and vulnerable groups

- 4.7 Since the objective of the ERCERP is to reduce poverty levels by 50% by 2015, program actions in the areas of health, education, and social welfare will largely focus on meeting the unmet needs of this segment of the population. In health, for example, there are key maternal health indicators, while for education and social welfare there are activities, targets, and indicators for rural areas that are marginalized in terms of basic services coverage and also have a concentration of the country's poverty and extreme poverty. More importantly, monitoring of budget lines will enable the country and the Bank to effect more realistic control and monitoring of budget allocations to meet the education, health, and social welfare needs of these groups.

F. Social equity and poverty reduction classification

- 4.8 Because the program beneficiaries are the people of Nicaragua, including high-risk groups, this proposed operation qualifies as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). The targets and indicators for monitoring the program will reflect the performance of actions to measure social equity enhancement.
- 4.9 Although the proposed program is intended to support poverty reduction in the context of the ERCERP, it does not qualify as a poverty-targeted investment (PTI), because it is a fast-disbursing policy-based operation.

MATRIX OF CONDITIONS

Problem	Action	Impact	Disbursement conditionalities	
			First tranche	Second tranche
Macroeconomic environment				
Instability and low growth hinder implementation of the ERCERP.	A macroeconomic environment consistent with program objectives is maintained.	Stability favors execution of the ERCERP.	A macroeconomic environment consistent with program objectives is maintained.	A macroeconomic environment consistent with program objectives is maintained.
I. Social indicators related to ERCERP targets				
Fulfillment of ERCERP targets requires intermediate indicators to regularly monitor progress towards fulfillment.	The intermediate indicators progress annually, in accordance with the targets in Annex III.	The GON's capacity to monitor and direct poverty reduction policies is improved.	(i) Presentation by the SECEP, to the Bank's satisfaction, of the report on annual intermediate indicators agreed to with the sectors, baseline values, the calculation methodology, and sector officials responsible for producing the information (See Annex II). (ii) New operating rules for the Supplementary Social Fund (FSS) approved by the FSS Coordinating Council.	(i) Presentation to the Bank's satisfaction of the report demonstrating fulfillment of the targets for the 2002 and 2003 intermediate indicators, based on the quarterly reports of the FSS, which are based on information from the Integrated Financial Management, Administration, and Auditing System (SIGFA) and the National Public Investment System (SNIP). (ii) Evidence that the status of fulfillment of annual ERCERP targets has been disseminated through different media nationwide.
II. Prioritization and monitoring of social spending				
Maintaining expenditure in priority sectors, in accordance with the breakdown presented in Annex III				
When there is fiscal pressure, priority social programs suffer budget cuts.	Nicaragua approaches a level and breakdown of expenditure that guarantees the population access to basic services.	Education, health, and social welfare levels and indicators improve, and there is an increase in human capital and poverty reduction potential.	Education: That the 2003 General Budget of the Republic includes resources to meet the physical and financial targets identified in Annex III.	Education: The 2004 General Budget of the Republic includes resources: (i) that are no less than the corresponding allocations in the 2003 Budget; and (ii) that are sufficient to meet the physical and financial targets identified for that period in Annex III. Evidence supported in an official SECEP report demonstrating that the physical and financial targets for the 2003 priority programs indicated in Annex III were met or surpassed.

Problem	Action	Impact	Disbursement conditionalities	
			First tranche	Second tranche
			<p>Health:</p> <p>That the 2003 General Budget of the Republic includes resources for the budget lines that allow for the corresponding physical and financial targets established in Annex III to be met.</p> <p>That the 2001 baseline is presented for the percentage of total public spending allocated to MINSA.</p> <p>That the 2001 baseline is presented for recurrent per capita spending on primary health care in at least ten SILAIS.</p>	<p>Health:</p> <p>The 2004 General Budget of the Republic includes resources: (i) that are no less than the corresponding allocations in the 2003 Budget; and (ii) that are sufficient to meet the physical and financial targets identified for that period in Annex III.</p> <p>Evidence supported in an official SECEP report demonstrating that the physical and financial targets for the 2003 priority programs indicated in Annex III were met or surpassed.</p> <p>Evidence supported in an official SECEP report demonstrating that: (i) the percentage of total public spending allocated to MINSA; and (ii) the amount of per capita recurrent spending on primary health care in the ten SILAIS identified in the first tranche, are not less than the baseline levels for the first tranche.</p>
			<p>Social welfare:</p> <p>That the 2003 General Budget of the Republic includes resources for the budget lines that allow the corresponding physical and financial targets established in Annex III to be met.</p>	<p>Social welfare:</p> <p>The 2004 General Budget of the Republic includes resources: (i) that are no less than the corresponding allocations in the 2003 Budget; and (ii) that are sufficient to fulfill the physical and financial targets identified for that period in Annex III.</p> <p>Evidence supported in an official SECEP report demonstrating that the physical and financial targets for the 2003 priority programs indicated in Annex III were met or surpassed.</p>

Problem	Action	Impact	Disbursement conditionalities	
			First tranche	Second tranche
III. Management of the ministries associated with execution of the ERCERP				
A. Education				
<p>Although school autonomy has been implemented since 1993, its legal and administrative foundation is based on MECD administrative rulings.</p>	<p>The Law on Participation in Education (LPE) and its regulations and standards are approved.</p> <p>The formula for transferring resources is modified.</p>	<p>The legal and administrative foundation of the school autonomy system is consolidated.</p> <p>Inequities and inefficiencies resulting from application of the transfer formula are reduced.</p>	<ol style="list-style-type: none"> 1. Entry into force of the Law on Participation in Education (LPE), with the text approved by the National Assembly in March 2002. 2. That the following ministerial agreements have been issued and are in effect: <ul style="list-style-type: none"> • Operation of the electoral and ethics supervisory body; • Functions and powers of the assemblies of parents; • Functions and powers of the councils of teachers; • Organization and operation of student governments; and • Functions and powers of school boards, including the process of electing, replacing, and re-electing their members and how the entities described will be trained, evaluated, and supervised. 3. That the formula for administering and managing regular and special transfers of resources from the General Budget of the Republic is amended, to promote equitable treatment of schools by level and size, meeting the specific objectives agreed to with the Bank (paragraph 2.11 of the loan proposal). 	<ol style="list-style-type: none"> 1. That the ministerial agreements reached for the first tranche have been disseminated to at least 25% of the schools. 2. That the following have been approved and put into effect: <ul style="list-style-type: none"> • A manual of procedures for the financial administration of schools in the participation-in-education system that includes regulations on administering and managing regular and special transfers of resources to schools; • A manual of procedures for adding new schools to the participation-in-education system. 3. That resources have been transferred to the schools by applying the resource transfer formula agreed to for the first tranche

Problem	Action	Impact	Disbursement conditionalities	
			First tranche	Second tranche
<p>B. Health</p> <p>The outlook of low spending is in a context of: (i) insufficient regulation (a new General Health Law was recently adopted, but a major regulatory effort is needed); (ii) disorganized and inefficient service delivery (there are multiple primary care models, with increased spending, but small gains in service production); (iii) highly-centralized decision making in hospitals; (iv) distortions in the make-up of the payroll, from payment of retirees and pensioners; and (v) inefficient purchase and distribution of drugs.</p>	<p>Regulation of the General Health Law (LGS).</p> <p>Unified primary care model.</p> <p>Increased autonomy of hospitals and local health systems (SILAIS).</p> <p>Reduced budget burden of manpower liabilities.</p> <p>Unified policy on the supply, management, and use of medical inputs.</p>	<p>Health in the country is improved by giving MINSA the competence and capacity to regulate the sector, streamline personnel expenditures, and make service delivery more efficient.</p>	<ol style="list-style-type: none"> 1. That the General Health Law (LGS) has entered into force. 2. That a plan of action has been presented for regulation of the LGS, including: (a) the operation, financing, and benefit plans of current contribution, no contribution, and voluntary schemes; (b) the organization and operation of the governing and consultative bodies of service delivery institutions, stressing hospital advisory boards, including users' rights; (c) the decentralization, deconcentration, and delegation models within the health sector, emphasizing mechanisms for promoting the transfer of competencies and resources; (d) the quality assurance system, including the authorization and accreditation of service providers; and (e) care programs for high-cost illnesses, including the requirement that delivery of medical services comply with health regulations. 3. That progress has been made in defining a new, unified primary health care model, including: (i) the definition of the methodology for evaluating current models; (ii) the definition of the terms of reference for a consulting firm to develop the new model; and (iii) the selection of said firm. The terms of reference for the evaluation must include a cost-effectiveness analysis of the selected programs. 4. Presentation to the SECEP of the consensus framework agreement between the MHCP and MINSA regulating the transfer of resources within the hospital decentralization system. 	<ol style="list-style-type: none"> 1. That the regulations for the General Health Law in the areas mentioned in the first tranche have entered into force. 2. That the unified primary health care model has been approved and adopted as the mandatory standard for implementation, regardless of source of financing, and that the adjustments for applying the unified model in projects currently under way are in the process of being negotiated with the financing institution. 3. That at least four hospitals: (i) have operating advisory boards; and (ii) have received a transfer of budget resources, in application of the MHCP-MINSA agreement agreed to for the first tranche.

Problem	Action	Impact	Disbursement conditionalities	
			First tranche	Second tranche
C. Social welfare				
<p>Problems persist in providing services in the poorest, most marginalized areas.</p> <p>Proliferation of programs with low coverage, lack of clarity in the target population, and existence of different targeting instruments.</p>	<p>Unification of targeting methodologies.</p> <p>Reorganization of social welfare programs in a manner consistent with the needs of vulnerable populations.</p> <p>Social welfare programs are evaluated according to their impact.</p>	<p>A higher percentage of spending targets populations living in extreme poverty.</p> <p>Social welfare actions are coordinated.</p> <p>The effectiveness of expenditures is evaluated.</p>	<p>That the following have been presented to the Bank's satisfaction:</p> <ol style="list-style-type: none"> 1. Ministerial agreement approving the formulation of a common methodological basis for targeting MIFAMILIA social welfare programs, based on the lessons learned in Phase I of the Social Safety Net Program and Phase I of the Comprehensive Child Care Program (PAININ). 2. An action plan for reorganizing and/or consolidating low-coverage MIFAMILIA social welfare programs. 3. The methodology for evaluating PAININ; and the terms of reference for evaluating the WFP program for Nicaragua, including identification of the control group and hypotheses and indicators to be included, and independent data collection and analysis. 4. A plan for the administrative reorganization of the WFP program for Nicaragua. 	<ol style="list-style-type: none"> 1. That MIFAMILIA social welfare programs are using the common methodological basis for targeting agreed to with the Bank for the first tranche. 2. That MIFAMILIA social welfare programs have been reorganized and/or consolidated in accordance with the plan of action presented for the first tranche and that said reorganization is reflected in the budget lines of the General Budget of the Republic. 3. That a consolidated administrative unit has been formed for WFP programs in Nicaragua. 4. That the evaluation baseline is presented, collected by independent firms, for PAININ and the WFP programs.

**SOCIAL POLICY REFORM PROGRAM TO SUPPORT THE ERCERP (NI-0169)
GLOBAL TARGETS AND INDICATORS AND INTERMEDIATE TARGETS**

ERCERP targets for 2015	Intermediate indicators	Annual Targets				
		Baseline 2001	2002	2003	2004	2005
EDUCATION						
To increase access to preschool and primary education.	Initial preschool enrollment in rural municipios	84,524	93,500	97,240	101,130	105,175
	Initial primary school enrollment in municipios with severe and high poverty	247,679	271,630	282,495	293,795	305,547
	Initial enrollment in grades 1 to 6 in rural areas	451,558	499,831	514,362	529,793	545,687
	Enrollment in adult education	83,413	91,754	94,506	97,342	100,262
HEALTH						
To reduce maternal mortality by 75% with respect to 1994 levels.	# of institutional deliveries in 10 priority SILAIS	37,175	38,675	40,175	41,675	43,175
	# of first prenatal check-ups in the first trimester of pregnancy in 10 priority SILAIS	33,870	35,670	37,470	39,270	41,070
To reduce mortality in children under one by 66% with respect to 1994 levels.	# of first fertility check-ups in women of childbearing age in 10 priority SILAIS	175,631	183,631	191,631	199,631	207,631
	# of children under one immunized with the third dose of the polio vaccine in 10 priority SILAIS	79,665	83,165	84,411	88,109	91,951
	# of children under one immunized with the third dose of the five-in-one vaccine (pentavalent) in 10 priority SILAIS	79,011	83,165	84,411	88,109	91,951
	# of children immunized with one dose of BCG in 10 priority SILAIS	86,647	88,147	89,647	91,147	92,647
SOCIAL WELFARE						
To reduce extreme poverty by 50% with respect to 1995 levels.	# of beneficiary families	10,000	13,000	15,000	20,000	20,000
	# of beneficiaries of food coupons	58,000	75,400	87,000	108,000	108,000
	# of beneficiaries of school packs (children 7 to 13)	15,642	20,334	23,463	31,284	31,284
	# of beneficiaries of school incentive coupons (children 7 to 13)	15,642	20,334	23,463	31,284	31,284
	# of beneficiaries of coupons for health and education	48,000	49,400	57,000	68,000	68,000
	Coverage of rural families living in extreme poverty served by the Social Safety Net Program	12%	16%	18%	24%	24%

NICARAGUA
SOCIAL POLICY REFORM PROGRAM TO SUPPORT THE ERCERP
PRIORITY BUDGET LINES AND CATEGORIES
(In millions of U.S. dollars)

Line	Code	Item	2002	2003 Target
Education			43.3	46.0
Line 521		Educational institutions (school autonomy)	41.5	43.4
Line 119		Other education incentives (“Aprende” [Learn] project, part of the component, improvement of education quality)	0.8	1.1
Lines 131, 137, 139, 193, 244, 273, 345, and 394		PAEBANIC (adult education)	1.0	1.4
Health			11.8	12.7
Line 365		Medicinal and pharmaceutical products (sources 11 and 18)	9.5	9.9
	206S023	Hospital equipment maintenance program	0.1	0.2
	206T016	Strengthening rural primary care (a FSS program)	1.7	1.2
	206T089	Rehabilitation of the hospitals in Puerto Cabezas, Bluefields, and San Carlos	0.01	0.2
	206T104	Provision of surgical equipment to health units	-	0.4
	206T112	Rehabilitation of national hospitals (in Managua and the departments)	0.4	0.6
Social welfare			2.3	1.5
	211T002	MIFAMILIA social safety net	0.4	0.4
	210T089	MECD/MIFAMILIA social safety net	0.3	0.1
	206T074	MINSA/MIFAMILIA social safety net	0.6	0.08
	237T044	PAINAR	-	0.03
Line 232		Maintenance and repair of transport facilities	0.01	0.01
Line 273		Domestic per diems	0.05	0.05
Line 524		For charitable institutions (source 11)	0.3	0.3
Line 579		Other transfers for non-corporate autonomous entities (source 11, does not include program 99 “INIM”)	0.4	0.4
TOTAL protected in 3 sectors / national budget			57.4	60.3

Note: The source for the execution amounts is the MHCP. The following exchange rates will be used: 14.20 for 2002 and 15.10 for 2003. These lines reflect the numbering in SIGFA 2003.

BREAKDOWN OF PHYSICAL AND FINANCIAL TARGETS FOR 2003

Line/Code	2003 Physical targets				TOTAL	2003 Financial targets				TOTAL
	I	II	III	IV		I	II	III	IV	
Education										46.0
Line 521	Disbursement of transfer to 100% of schools in the participation-in-education system.	Disbursement of transfer to 100% of schools in the participation-in-education system.	Disbursement of transfer to 100% of schools in the participation-in-education system.	Disbursement of transfer to 100% of schools in the participation-in-education system.		10.85	10.85	10.85	10.85	43.4
Line 119	32,770 incentives delivered.	18,150 incentives delivered.	32,770 incentives delivered.	18,150 incentives delivered.	53,540 managers, primary school teachers, and volunteers benefited.	0.44	0.12	0.44	0.12	1.1
Lines 131, 137, 139, 193, 244, 273, 345, and 394	140,532 texts purchased. Revision of the literacy work plan.	46,844 texts purchased.			187,376 texts purchased; 149,000 school supplies purchased; 50,000 persons taught to read and write.	0.35	0.36	0.37	0.39	1.4
Health										12.7
Line 365	Verification of the list of products to be purchased. Awarded by competitive bidding.	Payment of providers in accordance with deliveries. Distribution of inputs.	Payment of providers in accordance with deliveries. Distribution of inputs.	Distribution of inputs. Distribution of inputs.	Purchases: 10% on vaccines; 6.6% Red Cross; 43% drugs; 34% replacement materials; 5.4% laboratory	2.31	2.98	2.98	1.65	9.9
206S023	Identification and verification of the list of equipment to be repaired.	Equipment repair according to the list in the maternal and child care ward of five hospitals.	Equipment repair according to the list in the maternal and child care ward of five hospitals.			0.65	0.65	0.87		0.2
206T016	240 nurses and physicians hired and salary paid.	Salary paid to 240 human resources.	Salary paid to 240 human resources.		240 nurses and physicians.	0.47	0.47	0.3		1.2
206T089	Validation of rehabilitation needs in three hospitals. Bidding of works.				Hospitals of Puerto Cabezas, Bluefields, and San Carlos rehabilitated.	0.07	0.07	0.1		0.2
206T104	Validation of the list of surgical instruments and list of beneficiary institutions prepared. Awarded by competitive bidding.	Distribution of the instruments.	Distribution of the instruments.		70% of surgical instruments delivered to hospitals and 30% to health centers.	0.13	0.13	0.17		0.4

206T112	Validation of critical path rehabilitation needs in five hospitals. Bidding of works.				Critical path in five hospitals rehabilitated.	0.18	0.18	0.25		0.6
Social welfare										1.5
211T002 210T089 206T074	3,500 new families added. Work plan completed for the expansion of Phase II of the program.	Activities progress in keeping with the approved work plan.	Activities progress in keeping with the approved work plan.	Activities progress in keeping with the approved work plan.		0.16 0.04 0.02	0.1 0.02 0.02	0.1 0.02 0.02	0.1 0.02 0.02	0.4 0.1 0.08
237T044	600 beneficiaries added.	200 beneficiaries added.	200 beneficiaries added.	200 beneficiaries added.	1,200 beneficiaries.	0.01	0.008	0.008	0.008	0.03
Line 232						0.007	0.003	0.003	0.003	0.01
Line 273	387 field visits.	387 field visits.	387 field visits.	387 field visits.	1,548 field visits for program supervision.	0.011	0.014	0.014	0.017	0.05
Line 524 Line 579	74 centers receive transfers.	74 centers receive transfers.	74 centers receive transfers.	74 centers receive transfers.	74 centers have received transfers (27 protection shelters, 29 infant development centers, and 18 nursing homes).	0.08 0.1	0.08 0.1	0.08 0.1	0.08 0.1	0.3 0.4
TOTAL protected in 3 sectors / national budget						60.3				

**SOCIAL POLICY REFORM PROGRAM TO SUPPORT THE ERCERP
GLOBAL TARGETS AND PROXIMATE IMPACT INDICATORS**

ERCERP targets for 2015	Proximate impact indicators
EDUCATION	
<p>To achieve 90% access to primary education.</p> <p>To reduce the illiteracy rate to 10%.</p>	<p>% change in the net enrollment rate for grades 1-6.</p> <p>% change in the rate of children who have completed 4th grade in rural areas.</p> <p>% change in initial enrollment of new students in 1st grade.</p> <p>% change in enrollment in adult education.</p>
HEALTH	
<p>To reduce maternal mortality by 75% with respect to 1994 levels.</p> <p>To reduce mortality in children under one by 66% with respect to 1994 levels.</p>	<p>% change in the maternal mortality rate.</p> <p>% change in the mortality rate in children under one.</p>
SOCIAL WELFARE	
<p>To reduce extreme poverty by 50% with respect to 1995 levels.</p>	<p>% change in coverage, in municipios in extreme poverty, of families benefiting from the social safety net.</p> <p>% change in net enrollment in grades 1-4 in municipios in extreme poverty covered by the social safety net.</p> <p>% change in malnutrition indices in municipios in extreme poverty covered by the social safety net.</p>

POLICY LETTER

Policy Reform Program to Support the Enhanced Economic Growth and Poverty Reduction Strategy

1. Introduction

The economic objectives of the Government of Nicaragua are to reduce poverty and achieve sustainable, equitable economic growth. To that end, the Government of Nicaragua has established a clear socioeconomic strategy based on comprehensive organization of government finances, promotion of investment through pro-export incentives for conglomerates, and provision of a social safety net.

Those objectives are consistent with the pillars underlying the Enhanced Economic Growth and Poverty Reduction Strategy, which in addition to economic growth and social welfare, is also based on investment in human capital, governance, and institutional strengthening.

The government has identified priority guidelines for achieving its objectives; they include reaching the completion point of the Heavily Indebted Poor Countries (HIPC) Initiative and reducing the domestic debt burden. Those two actions would contribute to the objective of fiscal sustainability, while allowing for investment in the social sector, and would free up resources for private investment. In addition, the government has committed to implementing sectoral actions and institutional reforms, particularly in the areas of education and health.

2. Background: The Economic Context

The international environment in recent years has been predominantly adverse for the Nicaraguan economy. The downward trend in terms of trade has been one of the most severe stresses on the economy.

Domestically, some disruptions have contributed to the slackening of the economy. The 2000-2001 financial crisis that resulted from the fraudulent practices of a few banks had and continues to have significant consequences on government finances. The run on deposits during the crisis led to the extraordinary distribution of government securities, driving up domestic debt.

Moreover, the expansive fiscal policy of recent years, especially in 2000 and 2001, was not consistent with external events, particularly the decline in external financing. This policy contributed to the deterioration of the current account, which was financed primarily with international reserves. Political uncertainty from the elections and financial instability from the banking crisis made it impossible for monetary policy to stop the drop in international reserves.

3. The Economic Program and Social Policy

A. The government's economic program

In its objective to foster sustainable, equitable economic growth, the linchpin of the government's approach is an investment promotion strategy that, in a context of increasing globalization of the world economy, calls for pro-export incentives for conglomerates. This in turn requires investment in human capital and a social safety net that supports the most vulnerable sectors.

Clearly, this strategy requires macroeconomic stability, elimination of distortions, and reduced inefficiency in incentives for different economic agents. To maintain stability, the deterioration of government finances must be reversed and, in particular, public expenditure redirected. To that end, the current administration is committed to reaching a Poverty Reduction and Growth Facility (PRGF) arrangement with the International Monetary Fund.

In the context of negotiations with the Fund, a mechanism was established to monitor the track record of the government's economic program in 2002. Fiscal performance during the first half of the year was better than expected and was consistent with a monetary policy aimed at strengthening international reserves and reducing the domestic debt burden.

As a result of this excellent execution, negotiations with the Fund have continued, and an agreement is expected to be reached with that institution very shortly. This program will ensure the flow of resources to finance public expenditure directed at poverty reduction and at supplementing private factors of production. Moreover, successful implementation of this program in the first year would enable Nicaragua to reach the completion point of the HIPC Initiative.

The actions implemented in 2002 aimed at reaching an agreement with the International Monetary Fund include a series of reforms and policy measures. In the financial sector, the plan to liquidate the assets of banks liquidated during the financial crisis continued, and the financial system was strengthened by approving standards on conflicts of interest, lending to related parties, and money laundering prevention, as well as a reform on capital adequacy standards, evaluation and classification of assets, and supply.

In the area of governance, the government plans to reduce corruption as a way of lowering transaction costs, which prevent the economy from growing at a faster pace in the long term. One pillar of the fight against corruption has been the promotion of legal reforms and reforms to strengthen the judicial system; those measures include the amendment of the penal code as regards the criminalization of corruption offenses for public officials and financial offenses and the adoption of the law on the probity of public officials.

In the fiscal sector, a tax reform with an annual yield of 2.6% of gross domestic product (GDP) was approved, together with an effective adjustment of the General Budget of the Republic of 5 points of GDP compared to the previous year. One of the main aspects of the

budget cut, the main objective of which was to streamline government spending, enhance efficiency, and modify the make-up of the budget, was to defend those budget lines related to the government's social policy in the framework of the Enhanced Economic Growth and Poverty Reduction Strategy. Specifically, budget lines were identified in the areas of health, education, and social welfare that must be protected, establishing minimum levels consistent with the ceilings set in the National Budget.

B. Social policy and reforms to be undertaken

In its commitment to reaching the HIPC Initiative completion point, the Government of Nicaragua has made it a social policy priority to enact a Law on Participation in Education and a General Health Law and adopt an action plan for introducing an effective program based on experience from the pilot Social Safety Net Program.

Education

Nicaragua has made progress in the school autonomy process. Begun in 1993, it is based on: the transfer of resources to schools in the system; the participation of parents, teachers, and students in schools' administrative, financial, and academic affairs; and the existence of a school board for hiring and dismissing school personnel.

The Government of Nicaragua feels it is important to further develop school autonomy. A Law on Participation in Education was therefore enacted; its objective is to strengthen the role of parents, teachers, and students in school management. In issuing the regulations to this Law, the effective participation of parents on school boards will be ensured; a school development plan will be stipulated to improve instruction in schools; and the role and responsibilities of the Ministry of Education, Culture, and Sports will be determined as regards teacher supervision, evaluation, and training.

As part of this process, the autonomy system was revised, to amend the current formula for transferring resources, to eliminate inequities and inefficiencies in implementing the system. The main objectives of the change are sound use of statistical data on the number of students in autonomous schools and the creation of incentives, in accordance with compensation criteria based on the socioeconomic disadvantages of the population or location of the schools.

Health

The Ministry of Health has had normative and regulatory shortcomings, because it does not have an adequate legal framework. To improve this situation, a General Health Law was adopted in March 2002. The regulations to that Law will stipulate: the operation, financing, and benefit plans of the systems created; the model for decentralization and deconcentration of services; how users will participate on the advisory councils of service delivery institutions; a quality assurance system, including the authorization and accreditation of providers; and how high-cost illnesses and emergency care will be handled.

Steps must also be taken to streamline health sector spending and thus move forward in the commitments established in the Enhanced Economic Growth and Poverty Reduction Strategy. At present, the Ministry of Health is executing seven primary health care programs, which hinders supervision of certain actions, and in some cases efforts are duplicated, which drives up the cost of service delivery. It is therefore essential that a cost-efficiency analysis be conducted of the care models, to devise a single, unified model, thereby reducing fixed management costs.

Social welfare

There are significant limitations in this sector in providing services to the poorest, most marginalized areas. Delivery of services to vulnerable populations will help to meet the target on reduction of extreme poverty set in the Enhanced Economic Growth and Poverty Reduction Strategy. At present, there is a proliferation of programs with low coverage that generally lack targeting instruments. The Ministry of Family has established the need to unify targeting methodologies and evaluate programs to determine their cost-effectiveness. Upon completion of the evaluations, programs will be reorganized to streamline government spending in this sector. Special importance will be given to the second phase of the Social Safety Net Program, by monitoring the expansion, cost-effectiveness plan, targeting criteria and mechanisms, implementation, targets, and program evaluation. Other challenges include devising a care policy for vulnerable groups and strengthening the institutional framework for this sector.

4. Conclusions

The sound track record of the economic program within the framework of negotiations with the IMF and the social agenda set in the context of the HIPC Initiative demonstrates the commitment of the Government of Nicaragua to achieving its economic growth and poverty reduction objectives. The government acknowledges that, in the medium term, it will have to make progress on the institutional reforms stipulated in the Enhanced Economic Growth and Poverty Reduction Strategy, particularly in the education, health, and social welfare sectors. In this context, the policy reform program to support the strategy will facilitate implementation of the reforms needed to boost the country's economic development, in a framework of equity and poverty eradication.